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EXTRATERRITORIAL APPLICATION OF SECURITIES REGULATIONS: TERRITORIALISM IN THE WAKE OF THE OCTOBER 1987 MARKET CRASH

The notion of independence is always associated with the existence of a State, yet there are very few States in the world of which it is possible to say that they are absolutely independent of every other State whatever, nor even politically independent of every other State. States are bound to one another partly by treaties, and partly by duties that lie upon them, and control their freedom of action.¹

I. INTRODUCTION

The increased globalization of securities markets requires a close look at current models of extraterritorial application of securities regulations.² Recognizing that there is essentially only one market, a "world market," this comment examines the inter-relationship of

1. AMOS, LECTURES ON INTERNATIONAL LAW 34 (1983).

2. Although the various major markets are increasingly interdependent, they also retain individuality to a great extent in regulation. Integration of the regulation of major markets has been resisted. U.S. SECURITIES AND EXCHANGE COMMISSION, No. 1271, THE OCTOBER 1987 MARKET BREAK (1988) at 11-1 [hereinafter THE OCTOBER 1987 MARKET BREAK].

major markets,³ the ultimate necessity of cooperative regulation, and the establishment of principles of cooperative application of jurisdiction as an intermediate step toward that goal.

This comment will address the limits to extraterritorial application of securities regulations by the United States. These limitations include recognized principles of international law, the practical likelihood of effective enforcement, and constraints imposed by the 1934 Securities Exchange Act.⁴ This comment will then analyze jurisdictional models currently applied by U.S. courts. The objective of this comment is to (1) evaluate and determine the extent that United States courts can apply these tests to current conditions in the global securities market, and (2) to propose a model for the extraterritorial application of securities regulations which will provide protection for the inter-linked world economies while protecting territorial independence.

II. THE NEED FOR COOPERATIVE REGULATION: A LOOK AT THE OCTOBER 1987 MARKET BREAK

The crash of the New York Stock Exchange on October 19, 1987 has been described as a "global crash."⁵ The ripple effects of the crash impacted the markets in London, West Germany, and Japan.⁶ The global effect of this event should make the necessity for international cooperative regulation clear. No doubt these events enhance the worries of major market regulators. Indeed, even prior to the

3. Over the last decade the various securities markets around the world have become increasingly integrated psychologically and through improved communications technology. Regulatory barriers to investment in foreign markets are continually being decreased as investors look more to the world markets for alternative investment opportunities and as vehicles to adjust investment risk exposure. A time sequence analysis of the price movements in the Tokyo, London, and U.S. markets before and after the October market break clearly illustrates the linkage of these markets. By Friday, October 16, 1987, the Dow Jones Industrial Index declined by 9.6% from the opening on Monday, October 12. The Tokyo market reacted quickly creating heavy sell pressure on October 19 forcing the market down throughout the day closing down 2.3%. Trading then opened in London down 7.8% from the previous week and declined steadily throughout most of the day. After a brief afternoon rally, London closed down 12.6% at the close of October 19 trading. The U.S. market followed with a pre-open downturn of 10.9% from the previous Friday. When Tokyo opened the next day, 95% of the stocks were unable to open because of a sell-side order imbalance. The Nikkei Dow Jones Industrial Index (an index of 225 leading TKE stocks) fell 7.5% during the morning with a steady decrease during the day for a total drop of 14.7% for the day. *THE OCTOBER 1987 MARKET BREAK*, *supra* note 2, at 11-1, 11-5, 11-6.

4. 15 U.S.C. §§ 77a-77bbbb (1933).

5. *After the Meltdown of '87*, *NEWSWEEK*, November 2, 1987, at 14.

6. *Id.* See also *THE OCTOBER 1987 MARKET BREAK*, *supra* note 2, at 11-1 - 11-20 (discussing the interdependence of international securities markets).

October 19, 1987 market break, financial regulators in London and the United States recognized new risks and greater potential for damage stemming from increased market interdependence, prompting a concern that market regulators move toward common standards of regulation.⁷ The crash merely emphasized the reality, then and now, of the need for shared responsibility in the regulation of world markets, at least on the basic rules covering insider trading, fraud, and uniform registration and disclosure requirements,⁸ in order to prevent world-wide catastrophe.

An example of the need for cooperative regulation can be seen with the following hypothetical. Assume that a Japanese Investor (Investor) who owns substantial shares in Euromax, a corporation formed in Great Britain listing its securities on the London, Tokyo and New York stock exchanges, has information that Euromax is about to lose a highly lucrative contract that will force the stock price down substantially. Investor instructs his investment advisor to sell all his shares on the Tokyo Market. This in turn forces the price lower when trading opens in London and New York. British and American investors in Euromax could incur substantial losses because of the dramatic price failure. The question is where jurisdiction would be proper for the British and/or American investors (or the Securities and Exchange Commission) to bring an action against Investor on an insider trading claim. Cooperative regulation is necessary in protecting the interests of foreign and domestic investors and in safeguarding the integrity of the world securities markets.

Inasmuch as complete cooperative regulation may be a long term goal requiring a long period of transition, more immediate measures should be considered which resolve current problems and point in

7. *A Special Report, Global Finance & Investing*, Wall St. J., Sept. 18, 1987, at D16-D17.

8. As an example of cooperative regulation, the SEC has recently reached an agreement with the London Stock Exchange concerning SEC Rule 10b-6 which prohibits purchases and inducements to purchase during a "cooling off period" preceding distribution. SEC Rule 10b-6, reprinted in, 17 C.F.R. § 240.10b-6 (Supp. 1987). This period ranges from two to nine business days prior to the offer for sale. Since the broker-dealer schematics are different in the U.S. and U.K., 10b-6 restrictions effectively create a barrier to foreign corporations and affiliates who distribute in the U.S. Traditionally, the SEC's view was that the 10b-6 restrictions applied to syndicates outside the U.S. as well as U.S. affiliated purchasers. The SEC's rationale was that prices of securities outside the U.S. affect the prices of their affiliated securities within the U.S. In the accommodation reached between the SEC and the London Stock Exchange, the SEC has agreed to waive some of the 10b-6 restrictions, particularly where passive market making is involved. Bartos, *London Stock Exchange—SEC Agreement on Market Making*, INT'L. FIN. L. REV. 32 (Jan. 1988).

the direction of cooperative regulation.⁹ Past experience in extraterritorial application of antitrust regulation has shown that arbitrary imposition of United States standards is not the answer.¹⁰ As the U.S. increasingly exerts jurisdiction to enforce, extraterritorially, its domestic laws, accusations surface that the U.S. is attempting to unilaterally impose its self designed solution to a multinational problem. The international reaction is defensive, interpreting extraterritorial exercise of jurisdiction as intrusive and overbearing.¹¹

9. One example of cooperative regulation is the recent SEC proposal which attempts to harmonize minimum disclosure requirements for simultaneous multinational offerings in the United States, Canada, and the United Kingdom. The proposal introduces two approaches to harmonization: commonality and reciprocity. Under the commonality approach, each participating country would agree to one common disclosure instrument which would be filed in each jurisdiction. Under the reciprocity approach, each country would agree to minimum disclosure requirements. Each country would then have independent authority to review required offering documents upon filing in that jurisdiction. The SEC acknowledges that the reciprocal approach would be much easier to implement than would be the commonality approach. Merloe, *Internationalization of Securities Markets: A Critical Survey of U.S. and EEC Disclosure Requirements*, 8 J. COMP. BUS. & CAP. MKT. L. 249, 264-65 (1986).

An example of such cooperative regulation might be considered in the areas of automated trading. In conducting its post-market break analysis the SEC used the NYSE audit trail to identify the most active broker/dealers. Those firms provided information of various activities including order routing mechanisms and international trading. That analysis revealed the heavy consequences of program trading, particularly in "portfolio insurance" management. Portfolio insurance refers to a variety of hedging strategies to control market risk based on disciplined buying and selling, triggered by pre-set parameters relating to specific market indicators. Typically, these transactions provide little or no warning to trading specialists or other market participants of the amount of potential selling activity it represents. The dangers of program trading are intensified since this practice is often used by institutional traders with large blocks of securities.

The SEC post-break analysis revealed that on October 19 institutional investors traded slightly over 50% of the total market activity on the NYSE for the day. One major pension fund sold 27.3 million shares supplemented by an additional sale, on the 16th and 19th, of 7,000 "SPZ" contracts—equivalent to approximately 17.6 million shares with a dollar value of \$705 million. The latter sale was accomplished through thirteen programs to sell blocks of 2 million shares each. Information from the International Stock Exchange of the United Kingdom and Republic of Ireland, Ltd. (ISE) indicates that there may have been a number of transactions stemming from program trading executed on that market as well. Since the ISE does not require that all traders in foreign stocks be reported, complete information has not yet been available. See THE OCTOBER 1987 MARKET BREAK, *supra* note 2, at 1-2, 1-15, 2-2, 2-8, 2-15, 11-2.

Subsequent to October 19, the SEC has been rumored to show an escalated interest in regulation of program trading in light of these and other high impact problems. This may very well provide the SEC with a perfect opportunity to investigate the possibility of shared regulation of program trading on the international markets.

10. *Zoelsch v. Arthur Anderson & Co.*, 824 F.2d 27, 32 (D.C. Cir. 1987).

11. Grundman, *The New Imperialism: The Extraterritorial Application of United States Law*, 14 INT'L LAW. 257, 259 (1980). In conducting an analysis of jurisdictional reach, some authors have alluded that the problem lies not in the extraterritorial exercise of jurisdiction, but in the perception of foreign governments. It has been argued that some foreign countries fail to perceive the benefits of internationalization, preferring protectionism by enacting laws and adopting practices that discourage foreign investment. The problem, however, appears to be multilateral requiring concerted attention. See generally Charter & Beck, *Problems of Enforcement in the Multinational Securities Market*, 9 U. PA. J. INT'L. BUS. L. 467 (1987).

As the first step towards cooperative regulation, principles of jurisdiction to prescribe domestic regulations with extraterritorial application or effect should be clearly defined. Clarity may diminish claims of intrusive and over-reaching jurisdiction. First, regulations governing investment should insure neutrality,¹² predictability,¹³ and consistency¹⁴ in the exercise of jurisdiction over foreign initiated transactions. Second, accepted principles of sovereignty require extraterritorial application of laws to be minimally intrusive, with clear justification for the application and enforcement of regulations that exceed the limitations of customary principles of international law.¹⁵ Finally, maintenance of equality in the mutual protection of respective interests is also critical.¹⁶ Major market regulators must take steps now to insure a solid, consistent, and predictable model for the extraterritorial application of securities regulations. Cooperation in regulating world markets may follow.

III. INTERNATIONAL LAW AS A LIMIT TO JURISDICTION TO PRESCRIBE

Customary international law requires a panoramic view of independent sovereign interests whenever efforts are made to stabilize or regulate integrated international interests.¹⁷ In the traditional sense, jurisdiction is the distribution of authority,¹⁸ based on territorial independence.¹⁹ Sovereignty of State implies the right of a State to exercise jurisdiction within its own territory.²⁰ Such jurisdiction is necessarily exclusive, absolute, and susceptible of no limitation not imposed by itself.²¹ Thus, everything within the territory of a State is subject to complete control by domestic law.²²

Early territorialists held that borders were finite and the application of a state's law could reach no further than those borders.²³ The

12. FALK, *THE ROLE OF DOMESTIC COURTS IN THE INTERNATIONAL LEGAL ORDER* 22 (1964).

13. AMOS, *supra* note 1, at 22; Zoelsch, 824 F.2d at 32 n.2.

14. Zoelsch, 824 F.2d at 30-31; See also notes 82 to 87 and accompanying text.

15. FALK, *supra* note 12, at 25; AMOS, *supra* note 1, at 38-39; HINGORANI, *MODERN INTERNATIONAL LAW* 15 (1984).

16. AMOS, *supra* note 1, at 50.

17. Charter & Beck, *supra* note 11, at 469.

18. FALK, *supra* note 12, at 21.

19. *Id.*

20. HINGORANI, *supra* note 15, at 120.

21. FALK, *supra* note 12, at 29 (citing *The Schooner Exchange v. McFadden*, 11 U.S. (7 Cranch) 116, 136 (1812)).

22. *Id.*

23. Cornelis van Bynkershoek, an 18th century Dutch jurist, published several books

rule was clear, simple, and could be applied universally. However, the rule was not without shortcomings. This rigid view created an "immunity umbrella" for those who could act abroad to achieve illegal domestic objectives.²⁴ To counter such a restrictive view this rule induced an expansion of the authority to assert control over events with only a remote spatial contact with the claimant state.²⁵

Notwithstanding these problems, in the United States this territorialist view was consistently applied and acknowledged by the U.S. Supreme Court. In 1909 the U.S. Supreme Court held in *American Banana Co. v. United Fruit Co.*²⁶ that jurisdiction would not lie where a New Jersey corporation tortiously injured an Alabama corporation on foreign soil.²⁷ The Court expressed the "almost universal rule" that since all legislation is prima facie territorial, the character of an act as lawful or unlawful can only be determined by the law of the country where the act is done.²⁸

Significantly, *Banana Co.* recognized that comity between nations is an important goal. The plaintiffs argued that the value placed on the principles of comity cannot be extended so far as to "cloak a violation of the laws of the nation whose comity is appealed to."²⁹

concerning "positivist" theories of international law. Those publications, such as *De domino maris dissertatio*-Dominion of the Seas and *Quaestionum Juris Publice Libri Duo*-Questions of Public Law, supported early territorialism. Bynkershoek was the founder of the three mile rule of territorial waters initially based upon the range of a cannon shot. HINGORANI, *supra* note 15, at 18-19.

24. FALK, *supra* note 12, at 31.

25. *Id.*

26. 213 U.S. 347 (1909).

27. *American Banana Co. v. United Fruit Co.*, 213 U.S. 347 (1909). In *Banana Co.*, the plaintiff claimed that the defendant violated the Sherman Antitrust Act by wrongfully persuading the Costa Rican government to seize a railroad under construction and banana plantations (located in Panama) owned by plaintiff. *Id.* at 354-55. The primary concern of the Court was that the acts alleged completely took place on foreign soil—no conduct occurred within United States territory. *Id.* at 357. The Court held that there was no jurisdiction over extraterritorial acts, even where both parties were United States corporations. *Id.* at 357-58.

28. *Id.* at 357. The Court concluded that it should construe, as a matter of course, generic legislative phrases to apply only to persons subject to the legislation, not to everyone over whom the legislator could gain control. In the case of the Sherman Antitrust Act, the improbability of the United States attempting to regulate conduct on foreign soil is obvious. In the Court's view, it was entirely plain that the defendant's foreign activities were not within the scope of United States antitrust laws. *Id.*

The idea that legislation is prima facie territorial is not new, nor is it solely an American concept. In *Ex parte Blain*, decided in 1879, the Chancery Division of the English High Court of Justice declined jurisdiction over a bankruptcy action because the members of a firm doing business in Liverpool were domiciled in Chili and had never been to England. *Ex parte Blain*, 12 Ch. Div'l. Ct. 522, 528 (1879).

29. *Banana Co.*, 213 U.S. at 349 (citing *The Santissima Trinidad*, 20 U.S. (7 Wheat.) 283, 354 (1822); *The Bello Corrunes*, 19 U.S. (6 Wheat.) 152, 169 (1821); *The Marianna Flora*, 24 U.S. (11 Wheat.) 1 (1826); *The Merino*. *The Constitution*. *The Louisa*, 22 U.S. (9 Wheat.) 391, 405 (1824)).

The plaintiffs believed that illegality was being protected under the guise of national comity. However, the court, in holding for the defendants, did not intend to protect illegality with principles of comity. Rather, the Court noted that for a jurisdiction to treat a party according to domestic law instead of the law of the place where the act was committed not only would be unjust, but would be an interference with the authority of the other sovereign, and would result in justifiable resentment.³⁰

Other commentators, less concerned with formal territorial boundaries, have seen comity as an obligation among states³¹ to recognize and respect the relevant interests of foreign nations.³² The view of the Restatement of Foreign Relations Law of the United States, propounded by the American Law Institute, concerning comity,³³ (sometimes considered to incorporate a requirement of reciprocity), is that comity is not merely discretionary, but obligatory.³⁴ "The obligation, however, is not necessarily dependent upon any finding that another state would exercise jurisdiction in the same manner or to the same extent."³⁵ Reciprocity is, however, relevant to the extent of evaluation of other Restatement factors applied in making a determination of proper jurisdiction.³⁶

Thus, the maturation of principles of international law—principles that are both disciplined and flexible—impose limits on the power of a sovereign to apply its domestic laws extraterritorially.

IV. PRACTICAL LIMITATIONS ON THE EXTRATERRITORIAL ENFORCEMENT OF SEC REGULATIONS

Assuming for the moment that regulations of the Securities and Exchange Commission (SEC) fit into the framework of acceptable international rules for extraterritorial application of domestic law, an assessment of the ability of the SEC to gain assistance from foreign regulatory agencies in investigating and enforcing U.S. regulations is equally important. Three areas of difficulty impede the

30. *Banana Co.*, 213 U.S. at 356 (citing *Phillips v. Eyre*, [1870] 6 Q.B. 1, 28).

31. RESTATEMENT (REVISED) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 403 reporter's notes 8-9 (Tent. Draft No. 7 1986) [hereinafter RESTATEMENT (REVISED)].

32. *Romero v. International Terminal Operating Co.*, 358 U.S. 354, 382-83 (1959). See also RESTATEMENT (REVISED), *supra* note 31, § 403 reporter's comments 8-9.

33. RESTATEMENT (REVISED), *supra* note 31, § 403 reporter's comments 8-9.

34. *Id.* § 403 comment a.

35. *Id.*

36. *Id.* See *infra* notes 87-98 and accompanying text (discussion of factors relevant to determine whether the exercise of jurisdiction is reasonable).

enforcement of U.S. securities laws abroad. First, philosophical differences with respect to certain activity limits the sense of urgency by foreign agencies in assisting enforcement.³⁷ For example, some European and Far East countries consider tipping to be proper guardianship of a client's interests.³⁸ In fact, tipping is often regarded as a social duty expected of relatives and friends.³⁹ Although the trend over the past decade has been toward the illegalization of tipping, foreign agencies still may reflect a benign reluctance to aid foreign regulators in their preliminary investigations into such matters.⁴⁰

Second, the authority and jurisdiction of the cooperating foreign agency may also limit effective enforcement. For example, in France the *Commission des Opérations de Bourse*⁴¹ (*Commission*) is authorized to conduct securities investigations with an emphasis on protection of investors and the operational aspects of the French markets.⁴² A specific exception allows the *Commission* to assist foreign investigative agencies with respect to information already in the possession of the *Commission*,⁴³ but only where there is an agreement with the foreign agency (e.g., the SEC) guaranteeing reciprocity and secrecy.⁴⁴ Nevertheless, the exception is limited to information already in the hands of the *Commission*. Thus, investigation into undiscovered information is not subject to authorized assistance. This authority is further limited to companies who list their securities on the French *bourse* or over-the-counter exchanges.⁴⁵ Investigation of involvement of securities violations by unlisted subsidiaries may be problematic for the *Commission* in aiding foreign regulators in making their own inquiries.

In many countries, inquiry is cut short when the controlling agency determines that preliminary investigation is not warranted and there-

37. Pitt, Hardison & Shapiro, *Problems of Enforcement in the Multinational Securities Market*, 9 U. PA. J. INT'L BUS. L. 375, 390-91 (1987) [hereinafter Pitt].

38. Carlton & Fischel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857, 860 n.16 (1983).

39. Tunc, *A French Lawyer Looks at American Corporation Law and Securities Regulation*, 130 U. PA. L. REV. 757, 762 (1982).

40. Carlton & Fischel, *supra* note 38, at 860 n.16.

41. The *Commission des Opérations de Bourse* was created by Ordinance No. 67-833 instituant une commission des opérations de bourse et relative à l'information des porteurs de valeurs mobilières et à la publicité de certaines opérations de bourse, reprinted in Bordeaux-Groult, *Problems of Enforcement and Cooperation in the Multinational Securities Market: A French Perspective*, 9 U. PA. J. INT'L BUS. L. 453, 455 n.9 (1987).

42. Bordeaux-Groult, *supra* note 41, at 455.

43. *Id.* at 453.

44. *Id.* at 460.

45. *Id.*

fore refuses assistance where formal judicial proceedings have not been initiated. This can create a formidable "Catch-22" in that preliminary investigation is necessary to determine whether formal proceedings should in fact be pursued.⁴⁶

Third, blocking statutes may preclude enforcement.⁴⁷ For example, in France, brokers are subject to professional secrecy statutes⁴⁸ which prohibit the release of information related to client trading. Although the definition of what information is to be held in confidence is often difficult to determine, generally, any information that is not available in the public domain is considered secret.⁴⁹

Thus, while a court may have the *power* to hear a case and render a decision, that power is limited by two significant considerations: customary international law and the ability of regulatory agencies to effectively enforce domestic regulations implicated by international transactions.

V. STATUTORY LIMITATIONS ON JURISDICTION TO PRESCRIBE

Bringing an action in a U.S. court first requires that the court have personal jurisdiction over the parties.⁵⁰ However, the focus of this comment is on subject matter jurisdiction⁵¹ and personal jurisdiction is assumed.

46. Charter & Beck, *supra* note 11, at 470.

47. For a more detailed discussion of blocking statutes and retaliatory legislation see *infra* notes 118 to 125 and accompanying text.

48. Code Pénal [C. PEN.] art. 378 (Fr.), reprinted in Bordeaux-Groult, *supra* note 41, at 455 n.9.

49. Bordeaux-Groult, *supra* note 41, at 461.

50. International Shoe Co. v. Washington, 326 U.S. 310, 316 (1957); Hanson v. Denckla, 357 U.S. 235, 253 (1958); World Wide Volkswagen Corp. v. Woodson, 444 U.S. 286, 297-98 (1980); Burger King Corp. v. Rudzewicz, 471 U.S. 462, 474 (1985); Asahi Metal Ind. Co., Ltd. v. Superior Court, 107 S. Ct. 1026 (1987). Personal jurisdiction is established through certain minimum contacts that the defendant has with the forum state. Minimum contacts have been held sufficient to establish personal jurisdiction where the defendant purposefully avails himself of the privilege of conducting business within the forum state or where the defendant places its products into the stream of commerce with the expectation that they will be purchased by consumers in the forum state. Once the requirements of personal jurisdiction have been met, the court can then move to critical issues concerning jurisdiction to prescribe. Although In Personam jurisdiction is a critical element to be established in any litigation brought in the United States, this article assumes that such standards would be met. The recent decision of *Asahi*, contains a lengthy discussion of foreign corporate contact with the United States relative to the stream of commerce standards used in establishing In Personam jurisdiction. An analysis of this issue might involve a myriad of problems associated with multinational offerings or activity associated with international trading that is beyond the scope of this article.

51. Subject matter jurisdiction refers to the power of a court to hear and determine cases of the general nature or subject being presented to the court. Standard Oil Co. v. Montecatini Edison, 342 F. Supp. 125, 129 (D. Del. 1972).

The Securities Act of 1933 (S.A.) and the Securities Exchange Act of 1934 (S.E.A.) provide the initial basis for subject matter jurisdiction. However, even though securities regulations grant fairly broad jurisdiction, they do not give specific authority to American federal courts to apply United States securities regulations to claims arising from extraterritorial transactions.⁵²

Title 15, section 78aa (S.E.A.) establishes exclusive jurisdiction over violations of the S.E.A. in the federal courts. Title 15, section 78aa provides in relevant part as follows:

The [federal] district courts. . . and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this title or rules and regulations thereunder, or to enjoin any violation of such title or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found.⁵³

However, section 78dd of Title 15 states that the provisions of the Act and the rules and regulations promulgated by the SEC do not apply to any person who transacts business in securities⁵⁴ outside the jurisdiction of the United States unless the activity violates rules and regulations of the SEC that are enacted specifically to protect the

52. *Zoelsch v. Arthur Anderson & Co.*, 824 F.2d 27, 29-30 (D.C. Cir. 1987). Congress granted United States District Courts jurisdiction over violations of the Securities Act of 1933. 15 U.S.C. § 77v (1933). A plaintiff can bring an action in the district where the defendant is found, where the defendant is an inhabitant, where the defendant transacts business, or where the offer or sale took place. *Id.* The fact that the buyers of the securities were residents of a foreign country at the time of purchase does not necessarily preclude the district court from exercising jurisdiction under the Securities Act. *Ferland v. Orange Groves of Florida, Inc.*, 377 F. Supp. 690, 703 (D. Fla. 1974).

53. 15 U.S.C. § 78aa (1933). Although undecided, a stream of commerce analysis may assist a court to determine whether a litigant transacted business within the meaning of 15 U.S.C. § 78aa. An in depth study of this question is, however, beyond the scope of this article.

54. In *Zoelsch* the district court noted that AA-USA did not "transact business in securities." This begs the question of the meaning of the phrase "transacting business in securities" for the purposes of enforcement. It would seem that prospectus preparation might fall somewhere on the fringe of the definition.

integrity of market regulations in general. Title 15, section 78dd provides in relevant part as follows:

(a) It shall be unlawful for any broker or dealer, directly or indirectly, to make use of the mails or of any means or instrumentality of interstate commerce for the purpose of *effecting on an exchange not within or subject to the jurisdiction of the United States*, any transaction in any security the issuer of which is a resident of, or is organized under the laws of, or has its principal place of business in a place within or subject to the jurisdiction of the United States, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors or to prevent the evasion of this title. (b) The provisions of this title or any rule or regulation thereunder *shall not apply* to any person insofar as he transacts a business in securities *without the jurisdiction of the United States*, unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of this title (emphasis added).

The apparent focus of this section is to exempt foreign brokers, dealers or investors who trade securities of U.S. based corporations on foreign markets. In subsection (a) the language of the statute is clearly directed to transactions involving U.S. based issuers on foreign exchanges. Subsection (b) specifically applies an exemption to such activity on foreign markets. The plain meaning of the statute providing for the exemption is further supported by the courts in drawing the conclusion that concern over foreign transactions should be limited to those that in some way harm American investors.⁵⁵ Thus, in the absence of provisions that would extend the reach of SEC regulations, United States courts have consistently applied section 78dd as an exemption of foreign activity from United States jurisdiction. If then, on the face of sections 78aa and 78dd, the Act precludes extraterritorial jurisdiction, how do United States courts find jurisdiction behind this statutory language?

United States courts have found that the exclusion of jurisdiction under section 78dd(b) is not a protective shield for foreign transactions that in some way extend to this country.⁵⁶ What appears on its face to be a total statutory preemption from extraterritorial jurisdic-

55. *Zoelsch*, 824 F.2d at 32.

56. *UFITEC, S.A. v. Carter*, 20 Cal. 3d 238 (1977).

tion is in reality a very narrow exemption.⁵⁷ Thus, judicial interpretation in the United States of section 78dd, coupled with international trends toward less reserved principles of extraterritorial jurisdiction, shifted the focus of jurisdiction to more practical tests.

VI. CURRENT STANDARDS OF JURISDICTION TO PRESCRIBE

A. *Judicial Interpretation of Title 15 section 78dd*

As noted above, section 78dd exempts foreign activity, to some degree, from regulation by the United States under the S.E.A. In a recent opinion Judge Bork closely scrutinized section 78dd and the congressional intent behind the S.E.A.⁵⁸ finding that the S.E.A. had as its primary purpose the protection of American investors and markets.⁵⁹ Moreover, Judge Bork said that there was a clear implication that Congress was concerned with extraterritorial transactions only if they were part of a design to harm American investors or markets. In *Zoelsch v. Arthur Anderson & Co.*,⁶⁰ an action was brought by West German investors in U.S. federal district court (District of Columbia) against Arthur Anderson & Co., an Illinois corporation (AA-USA) based on claims that AA-USA provided information to its affiliate, Arthur Anderson & Co., GmbH (GmbH), a West German limited liability corporation, who in turn incorporated that information (either directly or indirectly) in a prospectus. The court held that the conduct by AA-USA did not constitute transacting business in securities, nor was it designed to harm American investors. The court emphasized that when the S.E.A. was enacted fifty years ago, Congress did not anticipate the complexity of transnational securities transactions. Thus, the *Zoelsch* court recognized that it was in the peculiar position of attempting to identify a "purely hypothetical legislative intent"⁶¹ behind section 78dd.

57. *Travis v. Anthes Imperial, Ltd.*, 473 F.2d 515 (8th Cir. 1973); cf. *Gurley v. Documentation, Inc.*, 674 F.2d 253 (4th Cir. 1982).

58. Unless Congress manifests a contrary intent, federal legislation applies only to activities that take place within the territorial jurisdiction of the United States. *Zoelsch*, 824 F.2d at 31. The court based its construction on the premise that Congress is primarily concerned with domestic conditions. *Id.*

59. *Id.* See also H.R. REP. No. 1383, 73rd Cong., 2d Sess. 1-16 (1934); S. REP. No. 792, 73rd Cong., 2d Sess. 1-13 (1934).

60. 824 F.2d 27 (D.C. Cir. 1987).

61. The *Zoelsch* court identified an evolution of cases which interpreted § 78dd. According to the Court, these cases significantly altered the application of the § 78dd exemption because they applied more recent concepts of extraterritorial jurisdiction. *Zoelsch*, 824 F.2d at 30.

The Court determined that Congress would not have intended that U.S. courts and agencies be devoted to predominantly foreign transactions rather than leaving those concerns to the country in which the transaction occurred.⁶² However, United States federal courts have considered the section 78dd exemption in a number of contexts and have permitted the exercise of extraterritorial jurisdiction⁶³ where significant conduct⁶⁴ occurs in the United States or where substantial effects of foreign activity are felt in the United States.⁶⁵

B. *The Restatement of Foreign Relations Law of the United States*

1. *The Conduct and Effects Tests*

Given the limitations of international law and the ability to enforce a law with extraterritorial application, two approaches were developed to be applied either concurrently or alternatively which expanded jurisdictional reach. The first is a "subjective territorial principle" where jurisdiction may be exercised over actions which occur, or may be related to conduct, within U.S. boundaries (*i.e.*, the "conduct test"). The second, an "objective territorial principle," extended jurisdiction to conduct which occurs outside U.S. territorial limits but which had some impact within the U.S. (*i.e.*, the "effects test").⁶⁶ These two models permit the exercise of jurisdiction over transactions that could not previously have been reached.

The Restatement (Second) of Foreign Relations Law of the United States section 17,⁶⁷ (Restatement (Second) or Restatement) extends

62. *Id.* The conflict only arises when the conduct occurs outside of the United States but has some effect within the United States. *Id.* Thus, an action that did not meet the "conduct test" could still meet the "effects test." *Id.*

63. *UFITEC, S.A. v. Carter*, 20 Cal. 3d 238 (1977).

64. See *United States v. Weisscredit Banca Com. E D'Invest*, 325 F. Supp. 1384, 1392-93 (S.D.N.Y. 1971); *SEC v. United Financial Group, Inc.*, 474 F.2d 354, 357-58 (9th Cir. 1973); *Leasco Data Processing Equipment Corp. v. Maxwell*, 468 F.2d 1326, 1333-37 (2nd Cir. 1972); *Schoenbaum v. Firstbrook*, 405 F.2d 200, 207-09 (2nd Cir. 1968). Note, however, that courts have expanded jurisdiction by applying the "conduct" and "effects" tests recently included within the provisions of the RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES [HEREINAFTER RESTATEMENT SECOND]. See *infra* notes 81-87 and accompanying text.

65. *Schoenbaum v. Firstbrook*, 405 F.2d 200, 208-09 (2nd Cir. 1968); *Des Brisay v. Goldfield Corp.*, 549 F.2d 133 (9th Cir. 1977).

66. *Bersch v. Drexel Firestone, Inc.*, 389 F. Supp. 446 (S.D.N.Y. 1974).

67. RESTATEMENT (SECOND) § 17 provides the framework for what is commonly referred to as the "conduct test." The American Law Institute has now encompassed this test in § 402

jurisdiction to include acts or omissions which occur within a territory's boundaries, even though the effect of the conduct may only be felt outside the territory.⁶⁸ For example, in *Leasco Data Processing Equipment Corp. v. Maxwell*,⁶⁹ the Second Circuit held that jurisdiction was proper over foreign transactions where fraudulent misrepresentations were made in the United States, inducing United States citizens to invest in securities offered by a British company on the London Stock Exchange.⁷⁰ The courts were also willing to adapt the conduct test to cases in which the plaintiffs were foreign nationals,⁷¹ placing no importance on the fact that damages were wholly independent of U.S. interests.⁷²

The second arm of expansion came about with the "effects test" of section 18 of the Restatement (Second).⁷³ Courts have interpreted the effects test broadly, reaching the constitutional limits of federal

of the revised Restatement. This section identifies a state's power to promulgate laws which regulate conduct so long as a substantial part of the conduct takes place within its territory. RESTATEMENT (REVISED), *supra* note 31, § 402 (Tent. Draft No. 7, 1985). Section 18 of the RESTATEMENT (SECOND) provides the framework for what is commonly known as the "effects test." The RESTATEMENT (REVISED) contains this test in § 402. This section provides that a state has the jurisdiction to control conduct that occurs outside of its territory which has, or is intended to have, substantial effects within its territory. *Id.*

68. *Leasco Data Processing Equipment Corp. v. Maxwell*, 469 F.2d 1326, 1326. See also *Recaman v. Barish*, 408 F. Supp. 1189 (E.D.Pa. 1974); *Bersch v. Drexel Firestone, Inc.*, 389 F. Supp. 446 (S.D.N.Y. 1974); *United States v. Clark*, 359 F. Supp. 131 (S.D.N.Y. 1973). Although the courts generally accept the principle behind the conduct test, the courts have not consistently applied it. Note, *Predictability and Comity: Toward Common Principles of Extraterritorial Jurisdiction*, 98 HARV. L. REV. 1310, 1315, n.28 (1985).

69. 468 F.2d 1326 (2d Cir. 1972).

70. *Leasco*, 468 F.2d at 1330-33. It is interesting to note a significant demarcation from the accepted principle of international law that a state is entitled to exercise jurisdiction over any conduct of its own nationals, even if the conduct occurs outside of its territory. The court partially determines the bases of jurisdiction on a finding of an entity's nationality. United States courts have freely asserted jurisdiction over multi-national entities based on agency doctrines, piercing the corporate veil, and other parent/subsidiary considerations. Note, *supra* note 68, at 1316-18.

71. *Continental Grain (Australia) Partnership Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409, 417-22 (8th Cir. 1979). See also *SEC v. Kasser*, 548 F.2d 109 (3rd Cir. 1977), *cert. denied*, 431 U.S. 938 (1977).

72. See *Zoelsch v. Arthur Anderson & Co.*, 824 F.2d 27, 29-30 (D.C. Cir. 1987); *Bersch v. Drexel Firestone, Inc.*, 389 F. Supp. 446 (S.D.N.Y. 1974). In *Zoelsch*, the D.C. Circuit was confronted with the issue of domestic conduct resulting in effects not felt in the United States. *Zoelsch*, 824 F.2d at 29. Although *Zoelsch* was not decided exclusively on this issue (the case turned on whether the conduct was substantial and whether it directly caused the harm suffered by the foreign nationals), the court seems to rationalize foreign effects as a proper basis of jurisdiction if the domestic conduct is substantial and causes harm abroad. *Zoelsch*, 824 F.2d at 33. See also *IIT v. Cornfeld*, 619 F.2d 909, 920-21 (2nd Cir. 1980); *cf. IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1017 (2nd Cir. 1975); *Leasco*, 468 F.2d 1326.

73. Although the effects test is derived from jurisdiction based on territoriality, it is increasingly recognized as a separate and distinct doctrine. RESTATEMENT (SECOND), *supra* note 67, § 402 comment d (Tent. Draft No. 7, 1985).

jurisdiction.⁷⁴ Under this test, conduct within U.S. territory is not necessary if a court bases subject matter jurisdiction on a *direct* and *substantial*⁷⁵ effect on domestic markets or investors.⁷⁶ In the area of economic regulation, where Congress is primarily concerned with domestic affairs, the presumption against extraterritorial application is strong.⁷⁷ However, courts have rebutted that presumption so as to permit the exercise of jurisdiction where there are allegations that the extraterritorial conduct produced domestic impact.⁷⁸

Controversy concerning the effects test commonly arises from application of the test to conduct that has some economic effect in the U.S. but which is lawful in the territory in which it occurs.⁷⁹ The drafters of Council Draft No. 7 of the Restatement defend the test by claiming that jurisdiction based on the effect of the challenged activity has been increasingly accepted, particularly in the European Community, in connection with regulation of restrictive business practices.⁸⁰

2. *Application of The Conduct and Effects Tests*

Several approaches have been used by the circuit courts in applying these jurisdictional tests to actions concerning conduct that is minimally a part of securities violations perpetrated primarily abroad. The result seems to be that, depending on which circuit the action happens to lie, *any* significant domestic activity, no matter how remotely connected to the primary transaction, can provide the basis of U. S. jurisdiction over the domestic actor if the conduct furthers

74. Kestenbaum, *Antitrust's "Extraterritorial" Jurisdiction: A Progress Report on the Balancing of Interests Test*, 18 STAN. J. INT'L L. 311, 312 (1982).

75. *IIT v. Vencap, Ltd.*, 519 F.2d at 1017 (citing RESTATEMENT (SECOND), *supra* note 67, § 18(b)(ii)).

76. *Zoelsch*, 824 F.2d at 30. See also *Shoenbaum v. Firstbrook*, 405 F.2d 200 (2d Cir. 1968); *Bersch v. Drexel Firestone, Inc.*, 389 F. Supp. 446 (S.D.N.Y. 1974).

77. *Foley Bros., Inc. v. Filardo*, 336 U.S. 281, 285 (1949).

78. *SEC v. Kasser*, 548 F.2d 109 (3rd Cir. 1977), *cert. denied*, 431 U.S. 938 (1977) (citing *Strassheim v. Daily*, 221 U.S. 280, 285 (1911)); *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945)); See also *Recaman v. Barish*, 408 F. Supp. 1189 (E.D.Pa. 1975); *Schoenbaum*, 465 F.2d at 220.

79. *Kasser*, 548 F.2d at 116. A rare controversy arises when effects are intended to encroach upon United States' interests but never do so. The Restatement view is that "when the intent of the persons sought to be charged is clear and the effect to be produced by the challenged activity is substantial and foreseeable, the fact that an act or conspiracy was thwarted before its effect was felt does not deprive the target state of jurisdiction to apply its law to that activity."

80. RESTATEMENT (SECOND), *supra* note 64, Council Draft No. 7, reporter's note 2. See *Imperial Chemical Industries Ltd. v. Commission (the Dyestuffs case)*, 11 Common Mkt. L.R. 557 (Ct. of Justice 1972).

a fraudulent scheme.⁸¹ The Second⁸² and D.C.⁸³ Circuits are the most restrictive, declining jurisdiction over domestic conduct that is "merely preparatory." The current standard in these circuits is that jurisdiction will lie only if the domestic conduct comprises all the elements of a defendant's conduct necessary to establish a violation of SEC regulations. Thus, in an action brought based on a violation of Rule 10b-5, a court must establish that the fraudulent statements or misrepresentations originated in the U.S., were made with scienter and in connection with the sale or purchase of securities, and caused the harm to those defrauded, even though the actual reliance and damages may occur elsewhere.⁸⁴

The Third, Eighth, and Ninth Circuits have relaxed the standard. The Third Circuit appears to be the most lenient, exercising jurisdiction where "at least some activity" involved in a fraudulent scheme occurs within this country.⁸⁵ The Eighth Circuit specifically rejected the Second Circuit's analysis in favor of a test that would allow jurisdiction if the domestic conduct was significantly in furtherance of a fraudulent scheme.⁸⁶ The Ninth Circuit is the middle ground between the approach of the Second and Eighth Circuits.⁸⁷ As a result of the differing approaches, there has been a loosening of the jurisdictional requirements.

3. Section 403—The Balancing Test

The most recent development in extra-territorial jurisdiction is the balancing of interests test of the latest revisions of the Restatement.⁸⁸ Traditional bases of jurisdiction are still effective⁸⁹ but the application of extraterritorial jurisdiction is further expanded. The drafters of the Restatement, recognizing the increasing magnitude of hostility on

81. *Zoelsch*, 824 F.2d at 30-31; *Tamari v. Bache & Co. (Lebanon) S.A.L.*, 547 F. Supp. 309 (N.D.Ill. 1982); *Plessey Co. PLC v. General Elec. Co. PLC*, 628 F.Supp. 477 (D.Del. 1986).

82. *Bersch*, 389 F. Supp. at 446; *IIT v. Vencap, Ltd.*, 519 F.2d 1001 (2d Cir. 1975); *IIT, an Intern. Inv. Trust v. Cornfeld*, 619 F.2d 909 (2d Cir. 1980); *AVC Nederland B.V. v. Atrium Inv. Partnership*, 740 F.2d 148 (2d Cir. 1984).

83. *Zoelsch*, 824 F.2d at 33; *Laker Airways v. Sabena Belgian World Airways*, 731 F.2d 909 (3d Cir. 1984).

84. *Id.*

85. *Kasser*, 548 F.2d at 114.

86. *Continental Grain (Australia)*, 592 F.2d at 418-20.

87. *Grunenthal GmbH v. Hotz*, 712 F.2d 421, 424 (9th Cir. 1983).

88. RESTATEMENT (SECOND), *supra* note 64.

89. *See supra* notes 60-74 and accompanying text.

the part of foreign governments and their courts,⁹⁰ developed the balancing test as an answer to international outcry.⁹¹

This test, as outlined in section 403 of the Restatement⁹² predicates the exercise of jurisdiction on reasonableness.⁹³ Therefore, even where the traditional bases of jurisdiction are met under section 402 (*i.e.*, conduct and effects tests), jurisdiction may not be exercised if to do so would be unreasonable.⁹⁴ In determining whether the exercise of jurisdiction would be reasonable, various factors are considered including (a) the conduct and effects tests, (b) connections, residence, or economic activity between the state and the parties, (c) the character of the regulated activity, (d) justified expectations that might be protected or hurt by the regulation in question, (e) international political, legal, or economic factors, (f) consistency with the traditions of the international system, (g) the extent another state has an interest in regulating the activity, and (h) the likelihood of conflict with regulation by other states.⁹⁵ In essence, the reasonable-

90. RESTATEMENT (SECOND), *supra* note 64, § 403, reporter's notes at 7. "Some states, particularly the United Kingdom, have questioned various applications of U.S. law as 'exorbitant.'" *Id.* See also Debates on the British Shipping Contracts and Commercial Documents Bill, 698 PARL. DEB. H.C. (5th ser.) 1215-83 (1964); Debates on the British Protection of Trading Interests Act 973 PARL. DEB. H.C. (5th ser.) 1535 (1979).

91. The drafters intended courts to apply this test as a limiting principle. RESTATEMENT (SECOND), *supra* note 64, § 403 reporter's note 2, at 8. Limiting U.S. Jurisdiction Under Principle of Reasonableness, at 8. In effect, however, this test has become an expansionary tool. Strong arguments have been made that balancing tests are not compatible with the principle of "comity among nations" because, in effect, they tend to de-emphasize foreign sovereign interests and almost never lead a court to decline jurisdiction. *Zoelsch*, 824 F.2d at 32, n.2. See also Note, *supra* note 68, at 1323-25. Thus, what was intended to be a jurisdictional restraint has fostered an extraordinary lack of restraint by United States courts. *Id.*

92. RESTATEMENT (REVISED), *supra* note 31.

93. Courts derived the reasonableness test from §§ 7, 17, 18 and 40 of the previous Restatement. The development of the reasonableness standard is understood "not as a basis for requiring that states consider moderating their enforcement of laws which they are authorized to prescribe, but as an essential element in determining whether, as a matter of international law, the state has jurisdiction to prescribe." RESTATEMENT (REVISED), *supra* note 31, § 403 reporter's note 10.

94. *Id.* § 403(1).

95. *Id.* § 403(2). Section 403 provides as follows:

(1) Even when one of the bases for jurisdiction under § 402 is present, a state may not exercise jurisdiction to prescribe law with respect to the activities, relations, status, or interests of persons or things having connections with another state or states when the exercise of such jurisdiction is unreasonable.

(2) Whether the exercise of jurisdiction is reasonable or unreasonable is judged by evaluating all the relevant factors, including, where appropriate,

(a) the extent to which the activity

(i) takes place within the regulating state; or

(ii) has substantial, direct, and foreseeable effect upon or in the regulating state;

(b) the connections, such as nationality, residence, or economic activity, between the

ness standard is a balancing test.⁹⁶ The balancing test is used in a generic sense to accommodate foreign interests.⁹⁷ In applying these Restatement factors to assess foreign interests, a U.S. court may take into account interests expressed by foreign governments, whether made through diplomatic channels, a brief *amicus curiae*, or by governmental declarations through parliamentary or political debates, press conferences or *communiqués*.⁹⁸ Similarly, the courts may consider declarations of U.S. interest expressed by the Executive Branch and its agencies.⁹⁹

4. Section 416—The Link Between section 403 and Securities Regulation¹⁰⁰

Section 416 of the Restatement extends further the jurisdictional standards of section 403 in applying U.S. securities regulations.¹⁰¹

regulating state and the persons principally responsible for the activity to be regulated, or between that state and those whom the law or regulation is designed to protect;
(c) the character of the activity to be regulated, the importance of regulation to the regulating state, the extent to which other states regulate such activities, and the degree to which the desirability of such regulation is generally accepted;
(d) the existence of justified expectations that might be protected or hurt by the regulation in question;
(e) the importance of the regulation in question to the international political, legal or economic system;
(f) the extent to which such regulation is consistent with the traditions of the international system;
(g) the extent to which another state may have an interest in regulating the activity; and
(h) the likelihood of conflict with regulation by other states.

Id. § 403.

96. *Zoelsch*, 825 F.2d at 32 n.2.

97. *Kestenbaum*, *supra* note 74, at 311.

98. *RESTATEMENT (SECOND)*, *supra* note 64, reporter's note 6, at 11.

99. *Id.* For example, a U.S. court may consider whether the United States Department of Justice declined to prosecute an action based on potential adverse effects on foreign relations between the countries involved.

100. Additionally, § 418 of the Restatement addresses the propriety of the exercise of jurisdiction over multinational entities on the basis of ownership and affiliation. Specific incidents of limited jurisdiction are outlined that allow, by direction through the parent entity, regulation of accounting, disclosure requirements, and tax regulations. Although general jurisdiction is not authorized solely on the basis of affiliation, jurisdiction may properly be exercised over foreign subsidiaries if the activity fits into the framework outlined in §§ 402 and 403 of the Restatement. *RESTATEMENT (REVISED)*, *supra* note 31, Vol. 2, Part IV.

101. *RESTATEMENT (REVISED)*, *supra* note 31, § 416 provides as follows:

Jurisdiction to Regulate Activities Related to Securities: Law of the United States.

(1) The United States generally has jurisdiction to prescribe with respect to

(a) i) any transaction in securities in the United States to which a national or resident of the United States is a party, and

ii) any offer to enter into a securities transaction, made in the United States by or

Section 416 of the Restatement incorporates both the conduct and the effects tests as well as the balancing test. The primary focus of this section is the protection of U.S. investors, U.S. securities markets, and those who trade on those markets.¹⁰² The reasonableness of exercising jurisdiction depends to a great extent on the character of the activity to be regulated.¹⁰³ For example, section 416 allows U.S. courts to exercise jurisdiction over conduct of a conspiratorial nature even though the conspirators never accomplished the transaction.¹⁰⁴

to a national or resident of the United States;

(b) any transaction in securities

i) carried out, or intended to be carried out, on an organized securities market in the United States, or

ii) carried out, or intended to be carried out, predominantly in the United States, although not on an organized securities market;

(c) conduct, regardless of where it occurs, significantly related to a transaction described in Subsection 1(b), if the conduct has, or is intended to have, a substantial effect in the United States;

(d) conduct occurring predominantly in the United States that is related to a transaction in securities, even if the transaction occurs outside the United States; and

(e) investment advice or solicitation of proxies or of consents with respect to securities, carried out predominantly in the United States.

(2) The jurisdiction of the United States to apply its securities laws to transactions or conduct other than those addressed in Subsection (1) depends on whether it is reasonable to do so in the light of § 403, giving particular weight to

(a) whether the transaction or conduct has, or can reasonably be expected to have, a substantial effect on a securities market in the United States for securities of the same issuer or on holdings in such securities by United States nationals or residents;

(b) whether representations are made or negotiations are conducted in the United States; and

(c) whether the party sought to be subjected to the jurisdiction of the United States is a United States national or resident, or the persons sought to be protected are United States nationals or residents.

Id. § 416.

102. RESTATEMENT (SECOND), *supra* note 64, § 416, comment a at 16.

103. *Id.* at 17.

104. *Id.* It is interesting to note also that RESTATEMENT (REVISED), *supra* note 31, § 418 (Tent. Final Draft 1985) sets forth provisions for jurisdiction with respect to activities of foreign subsidiaries. Under that section, subject to § 403, a state may have the power to exercise "limited" jurisdiction with respect to foreign branches of corporations organized under the laws of the state exercising such jurisdiction. However, jurisdiction may not ordinarily be exercised with respect to activities of corporations organized under the laws of a foreign state solely on the basis that they are owned or controlled by nationals of the state exercising jurisdiction. Moreover, the "reasonable" standards of § 403 incorporate additional factors found in § 418 with respect to activities of foreign entities. Those factors include:

activities of foreign entities

(a) by direction to the parent corporation in respect of such matters as uniform accounting, disclosure to investors, or preparation of consolidated tax returns of multinational enterprises; or

(b) by direction to the parent or the subsidiary in other exceptional cases, depending

VII. APPLICATION OF THE BALANCING MODEL

A. Viability of Balancing Interests

In *Zoelsch* Judge Bork criticized the balancing test for several reasons.¹⁰⁵ First he pointed out that application of balancing tests in antitrust litigation was unsuccessful because they were unpredictable and difficult to apply.¹⁰⁶ Although courts and commentators have argued that the balancing test, being both flexible and sophisticated,¹⁰⁷ enables the courts to consider a range of foreign interests and policies without being limited to specifically recognized immunities or defenses,¹⁰⁸ the balancing test has been found unworkable due to the impossibility of balancing totally contradictory and mutually negating interests.¹⁰⁹

One of the major decisions scrutinizing the use of a balancing test in antitrust actions was *Timberlane Lbr. Co. v. Bank of America, N.T. & S.A.*¹¹⁰ wherein the court stated that a judicially objective standard of comity should be applied as a matter of law, not merely as a matter of discretion.¹¹¹ The balancing test has also been criticized abroad on the grounds that such a test is an extremely difficult standard to apply; that comity is too uncertain in origin, content, and method of application to be relied upon; and that the courts simply cannot feasibly apply judicial techniques to balance the dis-

on all relevant factors, including:

- (i) whether the regulation is essential to implementation of a program to further a major, urgent national interest of the state exercising jurisdiction;
- (ii) whether the national program of which the regulation is a part cannot be carried out effectively unless it is applied also to foreign subsidiaries;
- (iii) whether the regulation is in potential or actual conflict with the law or policy of the state where the subsidiary is established; and
- (c) in the exceptional cases referred to in paragraph (b), the burden of establishing reasonableness is heavier when the direction is issued to the foreign subsidiary than when issued to the parent corporation.

Id.

105. *Zoelsch v. Arthur Anderson & Co.*, 824 F.2d 27 (D.C. Cir. 1987).

106. *Id.* at 32, n.2.

107. *Id.* at 32.

108. Kestenbaum, *supra* note 74, at 334.

109. *In re: Uranium Litigation*, 480 F. Supp. 1138, 1148 (N.D. Ill. 1979).

110. 549 F.2d 579 (9th Cir. 1976).

111. *Id.* See also SHENFIELD, EXTRATERRITORIALITY AND ANTITRUST, 5 TRADE REG. REP. (CCH) ¶¶ 50,386 and 55,857.

parate interests of national importance of two states.¹¹²

B. The Impact of Retaliatory Legislation: The Realism of International Tension

Whatever authority may be vested in the United States Congress to pass laws or regulations having extraterritorial effect is limited by the court's ability to enforce such measures. If foreign sovereigns refuse to recognize the propriety of a law or regulation and thereby refuse to permit enforcement, the validity of the regulation is seriously questioned. In the area of antitrust law, U.S. extraterritorial enforcement has given rise to intense international antipathy.¹¹³

In the wake of *In re: Uranium Antitrust Litigation*,¹¹⁴ a letter was issued by the U.S. State Department to the Seventh Circuit and the District Court stating that the court had caused serious embarrassment to the United States in its relations with its allies.¹¹⁵ The court was criticized for its unwillingness to apply reasonable standards in exercising jurisdiction, which, coupled with offensive remarks as to foreign government involvement in the case, created a dramatic potential for international confrontation.¹¹⁶

For instance, in *United States v. Imperial Chemical Industries Limited*,¹¹⁷ the English Court of Appeal granted an injunction preventing a party to litigation in the United States from obeying an order of the U.S. District Court of New York. A more dramatic and universal response to overreaching jurisdiction in general came in the form of the so-called blocking statutes. Although to some extent the tension was relieved by the ratification of the Hague Convention of

112. Case and Comment, *Protection of Trading Interests Act of 1980 (United Kingdom)*, 40 CAMBRIDGE L.J. 41, 42 (1981); Lowe, *Blocking Extraterritorial Jurisdiction*, 75 AM. J. INT'L. L. 257, 268-69, 281 (1981).

113. Foreign nations concerned with the extraterritorial reach of antitrust regulation have sometimes resented and protested broad assertion of jurisdiction by U.S. courts. *Timberlane Lmbr. Co. v. Bank of America, N.T. & S.A.*, 549 F.2d at 609. It is interesting to note that up to May 1973, the U.S. Dept. of Justice filed nearly 250 foreign trade antitrust cases, all of which were found to have proper jurisdiction. *Id.* at 608, n.12.

114. 480 F. Supp. 1138 (N.D. Ill. 1979).

115. Kestenbaum, *supra* note 74, at 323.

116. *Id.* Similarly, in OPEC cases, injunctive relief held the possibility of insult to the OPEC states adding international tension. *Id.* at 329, n.91.

117. 100 F.Supp. 504 (S.D.N.Y. 1951). See Pettit & Styles, *The International Response to the Extraterritorial Application of United States Antitrust Laws*, 37 BUS. L. 697, 698 (1982). However, a greater concern hence is the enforcement of investigatory and regulatory powers by administrative agencies in the U.S. such as the SEC. See notes 37 - 49 and accompanying text (regarding the power and authority of the SEC to investigate abroad).

1968,¹¹⁸ the saga of tension continued with the passage of the Protection of Trading Interests Act 1980 by the United Kingdom as a direct response to U.S. long-arm jurisdiction representing the high water mark of jurisdictional protectionism.¹¹⁹ Diplomatic response from the U.S. concerning the legislation was a request that Parliament should recognize that the bill would encourage confrontational rather than cooperative approaches to resolving these issues of mutual interest.¹²⁰

Canadian response to excessive jurisdictional reach was similar to that of the United Kingdom. In 1976 Canada amended the Combines Investigation Act of 1923 to grant powers to the Restrictive Trade Practices Commission to direct Canadian citizens to disregard certain foreign laws and judgments.¹²¹ In explaining the need for such legislation, Justice Minister Chretien commented that Canada felt that it was improper for a country to attempt to extend its jurisdiction to lawful activities that occur outside its territory.¹²²

In Australia, under the authority of the Foreign Proceedings (Prohibition of Certain Evidence) Act 1976, the Attorney-General has extensive powers to control the production of documents or oral evidence if it is found that the exercise of foreign jurisdiction would

118. The purpose of the Convention is "to facilitate the transmission and execution of letters of request [re: evidentiary matters] and to further the accommodation of the different methods which they use for this purpose and to improve mutual judicial recognition in civil or commercial matters." Hague Evidence Convention, March 18, 1970, 23 U.S.T. 2555, T.I.A.S. No. 7444, 847 U.N.T.S. 231. In ratifying the Convention, the United Kingdom declared pursuant to Article 23, that it would not execute letters of request issued for the purpose of obtaining pre-trial discovery of documents. Following the Hague Convention, the United Kingdom passed the Evidence (Proceedings in Other Jurisdictions) Act, 1975, which placed procedural restrictions and limitations on obtaining pre-trial discovery. In practice, the English courts attempted to give effect to requests for evidence sought by foreign courts. *Pettit & Styles, supra* note 110, at 700-01. In 1978, Lord Denning M.R. allowed discovery through letters rogatory in the first published opinion following the Evidence Act of 1975. In that opinion Lord Denning stated that "It is our duty and our pleasure to do all we can to assist that court, just as we would expect the United States court to assist us in like circumstances." *Id. (citing In Re Westinghouse Electric Corporation Uranium Contract, M.D.L. Docket No. 235 [1977] 3 All. E.R. 703, 708, revsd. sub. nom. RTZ v. Westinghouse, [1978] 1 All. E.R. 434)*. However, on appeal the House of Lords observed that what may be the policy of one state to defend may be the policy of another state to attack. *Id.* In response to that observation, the (then) Assistant U.S. Attorney General J. Shenfield stated that "those who preach comity should practice it. . . . We understand that comity is a two way street." Address to ABA Section of International Law, August 9, 1978, reprinted in *Extraterritorial Impact of U.S. Antitrust Laws, Trade Reg. Rep., Transfer Binder (CCH) ¶ 50,386 [hereinafter Shenfield]*.

119. Shenfield, *supra* note 118.

120. Shenfield, *supra* note 118, at ¶ 50,386 n.19; *Pettit & Styles, supra* note 117, at 702-06; See also Rosen, *The Protection of Trading Interests Act*, 15 INT'L LAW. 213 (1981).

121. *Pettit & Styles, supra* note 117, at 707.

122. *Id.* at 708.

be inconsistent with international law or comity, or if denial of such evidence would be in keeping with national interests.¹²³ This international stigma is also evidenced by legislation in the Netherlands, Italy, Germany, France, Belgium,¹²⁴ and South Africa.¹²⁵

Commentators have also argued that the "reasonableness" standards incorporated in the balancing test have relieved international tension to some degree. Decisions utilizing the reasonableness standard¹²⁶ were greeted as heralding an era of international understanding¹²⁷ and remedied some of the earlier international tension. However, the tension has not dissolved. If the intent of jurisdictional models was to gain acceptance and cooperation in regulation, it is apparent that this goal has not been achieved with the balancing test. Additionally, a lack of consensus and doubts about the factors of the balancing test raise questions about the consistency to be expected in future decision-making.¹²⁸

C. *Can the Balancing Test Survive Constitutional Scrutiny?*

A more complex question arising from application of the balancing test is how the separation of powers provisions of the Constitution of the United States may limit the exercise of extraterritorial jurisdiction. Fundamentally, the U.S. Constitution distinctly separates the branches of government by delegating the power to enact laws to Congress, the authority in diplomacy and foreign relations to the Executive branch, and the authority to interpret the laws enacted by Congress to the federal judiciary. Within this framework the judiciary is precluded from deciding questions that are political rather than legal.

The scope of this constitutional preclusion, commonly referred to as the "political question" doctrine, may from time to time extend to the outer limits of international law. The United States Supreme Court has observed that there are sweeping statements that all questions touching foreign relations are political questions.¹²⁹ However,

123. *Id.* at 709; see also Lacey, *Act of State and Extraterritorial Reach: Problems of Law and Policy*, A.B.A. SEC. OF INT'L L. & PRACTICE (1983).

124. Pettit & Styles, *supra* note 117, at 709.

125. *Id.* at 711-14.

126. *Timberlane Lmbr. Co. v. Bank of America, N.T. & S.A.*, 549 F.2d at 612, n.25; *Mannington Mills, Inc. v. Congoleum Corp.*, 595 F.2d 1287, 1297 (3rd Cir. 1979).

127. Kestenbaum, *supra* note 74, at 319.

128. *Id.* at 333, 336.

129. *Baker v. Carr*, 369 U.S. 186, 211 (1962).

notwithstanding that issues relating to foreign relations often rest on standards that defy judicial application or involve the exercise of discretion reserved solely to the executive or legislative branches,¹³⁰ these issues are not inherently outside the jurisdiction of the courts.¹³¹ In applying standards of justiciable determination to the authority of the United States Congress to prescribe securities regulations with extraterritorial effect, it is difficult at best to determine whether that power vested in Congress to make laws that necessarily involve international policy fall within or without the jurisdiction of United States courts.

The factors of the Restatement balancing test, particularly those requiring the balancing of national interests, implicate the political question doctrine directly. Judge Bork implies in *Zoelsch* that it is improper placement of authority for the judiciary to decide questions of foreign policy as required by the balancing test.¹³² Although one may argue that the test merely requires judicial interpretation of factual settings, one may also argue that due to the very nature of the factors,¹³³ application would be violative of the Constitution because the process is, in fact, a political interest determination, and hence a political question.¹³⁴ Thus, the factors comprising the Restatement test may transform a normally justiciable action into a political question.

In *Baker v. Carr*,¹³⁵ six factors were outlined for use in determining whether the question is political. The *Baker* factors were consolidated

130. *Id.*

131. In considering whether a dispute is within the framework of the political question doctrine, barring review by the courts, the question of justiciability might be resolved by determining whether the effect of the action in controversy is completely external to the United States. If so the action would fall squarely within the category of foreign affairs. *United States v. Curtiss-Wright Export Corp.*, 299 U.S. 304 (1936). Further, justiciability determinations have been made on the basis of whether there is a discoverable and manageable standard upon which the court can resolve the dispute. *Baker v. Carr*, 369 U.S. 186 (1962).

132. *Zoelsch v. Arthur Anderson & Co.*, 824 F.2d 27 (D.C. Cir. 1987).

133. RESTATEMENT (REVISED), *supra* note 31, § 403.

134. Some judges regard international law as *inherently* political. However, this view fails to recognize the importance of international legal norms and processes. Gordon, *American Courts, International Law and "Political Questions" Which Touch Foreign Relations*, 14 INT'L LAW. 297, 310 (1980). Moreover, it would be error to suppose that every case or controversy touching foreign relations is beyond judicial review. *Baker v. Carr*, 369 U.S. at 211. For example, the courts are not prevented by the political question doctrine from hearing cases that involve treaties, admiralty, or the status of aliens. *Baker v. Carr*, 369 U.S. at 208-26.

135. *Baker v. Carr*, 369 U.S. at 217. The six factors outlined in *Baker* are as follows: (1) a textually demonstrable constitutional commitment of the issue to a coordinate branch or department of the government, (2) a lack of judicially discoverable and manageable standard for resolving the dispute, (3) the impossibility of deciding the issue without an initial policy

in *Goldwater v. Carter*,¹³⁶ into three factors: (1) does the issue involve resolution of questions committed by the text of the Constitution to a coordinate branch of government? (2) would resolution of the question demand that a court move beyond areas of judicial expertise? and (3) do prudential considerations counsel against judicial intervention?¹³⁷

Applying these standards to the Restatement factors, it appears that such issues involving foreign policy require the courts to resolve conflicts beyond judicial expertise. In Judge Bork's opinion, Congress should amend laws that either offer no specific criteria for dispute resolution or loosely set forth criteria that require the balancing of political interests.¹³⁸ The responsibility for assessing the wisdom of policy choices and resolving competing interests does not lie with the judiciary,¹³⁹ rather such responsibility is vested in the political branches.¹⁴⁰ Further, past foreign reaction strongly counsels against judicial intervention. Judicial decisions based on policy resulted in retaliation based on policy.¹⁴¹

Although, the balancing test enables the courts to consider a wide variety of foreign interests and policies,¹⁴² the balancing test has been

determination that is outside the discretion of the court, (4) the impossibility of a court's undertaking independent resolution without expressing lack of respect for the coordinate branches of the government, (5) an unusual need for unquestioned adherence to a previously decided policy issue, and (6) the potential for embarrassment if the question were answered by more than one governmental department. *Id.*

136. 444 U.S. 996 (1979).

137. *Id.*

138. *Zoelsch v. Arthur Anderson & Co.*, 824 F.2d at 33.

139. *Id.* at 33; see also *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 866 (1984).

140. *Zoelsch v. Arthur Anderson & Co.*, 824 F.2d at 33 n.3. For a comparison of extraterritorial application of laws in Australia, see *The Extraterritorial Application of the Australian Antitrust Law*, 13 J. INT'L. L. ECON. 273 (1979); *Occidental of Umm al Qaywayn v. A Certain Cargo*, 577 F.2d 1196 (5th Cir. 1978). An interesting issue may arise as to the extent of policy evaluation based on administrative agencies of the federal government. For example, if the SEC decides to forego prosecution of a particular transaction where private parties also initiate an action, should the courts give weight to those considerations by the SEC? Assuming that the Department of State may directly collaborate with and advise the Department of Justice in relevant foreign policy concerns, "[a] court can feel more comfortable asserting jurisdiction if it knows that foreign policy concerns can be accommodated by the plaintiff [i.e. SEC] and are not left entirely to the court's untutored evaluation." *Zoelsch v. Arthur Anderson & Co.*, 824 F.2d at 33, n.3.

141. Rosen, *The Protection of Trading Interests Act*, 15 INT'L LAW. 213, 213-14 (1981). The Protection of Trading Interests Act 1980, passed in the United Kingdom was a direct response to the inability to settle such disputes through diplomatic channels. Pettit & Styles, *supra* note 117, at 701.

142. It has been urged that the governments concerned should file amici briefs at the early stages of litigation to promote the balancing test. Kestenbaum, *supra* note 74, at 332 n.63, 333 n.64.

criticized for that very reason. The Attorney General of Australia has stated that the balancing of national interests is a political function, not a judicial one.¹⁴³

Several courts have admitted that their decisions with regard to transnational securities transactions are based distinctly on policy¹⁴⁴ and have offered three justifications for the use of the balancing test.¹⁴⁵ First, by allowing jurisdiction here, other countries may be encouraged to take appropriate steps against parties who seek to perpetrate frauds in the United States. Second, exercise of jurisdiction will enhance the ability of the SEC to vigorously police the conduct of those who enter into securities transactions stemming into the United States.¹⁴⁶ Finally, to deny jurisdiction may invite defiance of regulation by those who wish to defraud foreign securities purchasers or sellers by using the United States as a base of operations. In *SEC v. Kasser*¹⁴⁷ the court concluded that Congress could not have intended the United States to become a "Barbary Coast" to harbor international securities "pirates."¹⁴⁸

However, these rationalizations are criticized by those who believe that Congress could not have intended jurisdiction to be exercised on the basis of foreign policy as Congressional concern was only with United States investors and markets.¹⁴⁹ When the Securities Act of 1933 and the Securities Exchange Act of 1934 were passed, Congress did not consider the reach of jurisdiction over cases involving predominantly foreign transactions¹⁵⁰ since the international connections in the securities markets were not nearly as extensive nor as complex as today.¹⁵¹ Under the *Goldwater* political question analysis, the Restatement factors of section 403 that question the importance of a regulation in the international political, legal or economic system, seem to fall squarely within the domain of the political question, rendering application of those factors beyond the scope of the judicial role.

143. *Id.* at 337.

144. *Continental Grain (Australia) Partnership Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409, 421 (8th Cir. 1979), citing *SEC v. Kasser*, 548 F.2d 109, 116 (3d Cir. 1977).

145. *Zoelsch v. Arthur Anderson & Co.*, 824 F.2d at 32.

146. *SEC v. Kasser*, 548 F.2d at 116; see also *Zoelsch* 824 F.2d at 32.

147. *SEC v. Kasser*, 391 F.Supp. 1167 (D.N.J. 1975).

148. *SEC v. Kasser*, 548 F.2d at 116.

149. *Zoelsch v. Arthur Anderson Co.*, 824 F.2d at 33.

150. *Id.* at 30.

151. Judge Bork, addressing the same rationalization, concluded that this rationalization was in fact sound reasoning why Congress should amend relevant statutes and why the courts should not do so. *Id.*

VIII. AN ALTERNATIVE MODEL

Recognizing the shortcomings of the balancing test, can those requirements be discarded? Assuming that the problems inherent in the balancing test, both realized and potential, warrant a supplantation of some other model, can a model be constructed that coordinates rather than complicates extraterritorial jurisdiction? A greater emphasis on principles of causation would strip away the complications that push courts into areas of foreign policy and political determinations better left for the other branches of government.¹⁵²

Causation, as it may be applied to jurisdictional principles related to securities regulation, evolves primarily from the "in connection with" provisions of section 10b and Rule 10b-5.¹⁵³ In *Wessel v. Buhler*¹⁵⁴ an accountant prepared financial statements, which a corporation used in preparing a prospectus. Plaintiffs alleged liability under Rule 10b-5 on the part of the accountant because, *inter alia*, the accountant's financial statements were made in connection with the purchase and sale of securities.¹⁵⁵ In rejecting the claim, the court acknowledged that the "in connection with" requirement has been broadly construed, but that "its reach is not boundless."¹⁵⁶ In so ruling, the court found that the accountant's statements were not publicly disseminated in such a way that would influence potential investors.¹⁵⁷ Thus, where conduct may be substantial in the overall scheme of a transaction, if the same conduct did not cause the investors to participate, jurisdiction would seem to be lacking.¹⁵⁸ Thus, causation parallels the "in connection with" requirements of section 10b and Rule 10b-5.¹⁵⁹

A. The Two Arenas of Causation

Causation may be divided into two arenas. First, "damages causation" requires that the acts giving rise to the litigation caused the

152. See *Bersch v. Drexel Firestone, Inc.*, 389 F. Supp. 446; see also *SEC v. Texas Gulf Sulphur*, 401 F.2d 833, 862 (2d Cir. 1968), (holding that jurisdiction would lie where the conduct was calculated to influence the investing public).

153. See generally *Zoelsch v. Arthur Anderson & Co.*, 824 F.2d 27, 34-35 (D.C. Cir. 1987).

154. 437 F.2d 279 (9th Cir. 1971).

155. *Id.* at 281.

156. *Id.* at 282.

157. *Id.*

158. *Id.* See also *Zoelsch v. Arthur Anderson & Co.*, 824 F.2d at 34-35.

159. *Zoelsch v. Arthur Anderson & Co.*, 824 F.2d at 34-35.

harm. Second, "transactional causation" requires that the act actually induced the investors to take part in the activity. Under this model, jurisdiction would lie where the conduct was calculated to influence the investing public.¹⁶⁰

To illustrate transactional causation, consider two hypothetical cases. International Property Investments (IPI), is a corporation to be formed in France to purchase prestigious income producing property located in key metropolitan cities around the world such as Paris, New York, and Tokyo. European Financial Group (EFG), a partnership organized under the laws of Germany, is targeted by IPI as a primary source for initial capital. Using capital raised by the first issuance of stock, IPI will purchase a high rise office complex located in New York.

Assume that one of the EFG partners is temporarily located in Washington D.C. for reasons totally unrelated to the transaction in question. Assume also that promotional presentations were previously made to all other EFG partners in France and that the absent partner's vote is necessary to consummate the transaction. Here, merely as an accommodation to the absent partner, a promotional presentation is made in Washington D.C. In this scenario the city where the presentation is made has no significance whatsoever in the transaction. The conduct (*i.e.*, the promotion) might be regarded as substantial in the overall scheme of the transaction, later consummated in France, but the connection with the location of the conduct is insignificant with regard to "transactional causation" in influencing the investor to decide to participate in the transaction. Here, although damages causation might be established, *i.e.*, the promotion can be linked to ultimate losses incurred by EFG, transactional causation is lacking. Thus, jurisdiction in a U.S. court would be inappropriate under these circumstances.

On the other hand, if all EFG partners insisted on viewing a potential property investment of IPI (*e.g.*, the New York high-rise) and the sales presentation was made at that location and the investment agreement to purchase shares in IPI was consummated in New York, the outcome would be very different.¹⁶¹ In this scenario both

160. *Id.* at 34.

161. For a parallel to this scenario, see generally *Gruenthal GmbH v. Hotz*, 712 F.2d 421 (1983) where the purchase of a foreign corporation was consummated in Los Angeles, California, U.S.A. That meeting was one of several meetings involved in negotiating the purchase but all other meetings were held in foreign countries, all corporate entities were foreign, and all parties to the purchase and sale were foreign nationals. The meeting was held

damages causation and transactional causation could be established, therefore legitimizing U.S. jurisdiction over the transaction.

This causation model might be viewed most appropriately on a spectrum ranging from absolute jurisdiction to complete denial of jurisdiction. At one end of the spectrum, absolute jurisdiction would be appropriate where both damages and transactional causation can be established. At the opposite end of the spectrum, complete denial of jurisdiction would occur where neither damages nor transactional causation could be established. Some difficulty may arise in those cases, as will be discussed, *infra*, that fall somewhere in the middle of the spectrum where only damages or transactional causation can be established. To a great extent, jurisdiction over these transactions will depend on whether the model is applied narrowly or broadly, and whether enforcement is pursued by private individuals or a regulatory agency.

B. Construction of the Causation Model

A fundamental question that must be addressed is whether the principles of causation should be construed broadly or narrowly. For example, consider again the earlier hypothetical involving the Japanese Investor who uses inside information and sells all his holdings in Euromax, the British corporation listing its securities on the London, Tokyo and New York stock exchanges. This in turn forces the price down when trading opens in London and New York. British and U.S. investors in Euromax incur substantial losses on those markets because of the dramatic price failure. A suit brought in a U.S. court against Investor presents difficult questions of whether U.S. and British investors (or the SEC) can sustain such an action based on insider trading claims.

If a U.S. investor in Euromax has no knowledge that the price is falling dramatically and, based on purely personal reasons, sells his holdings at a lower price than might have been obtained, what effect would these causation principles have on the domestic investor's claim? If these causation principles were given broad construction, it could be argued that damages were incurred by the investor because of a substantial price drop even though the investor was unaware of the price drop or the market participation by the Japanese Investor.

in Los Angeles for the convenience of air travel schedules and the intended consummation was scheduled to be concluded in the Bahamas. Jurisdiction was held to be proper based on the conduct in Los Angeles even though no effects impacted on U.S. citizens. *Id.*

Additionally, since the Investor's participation induced further transactions, *i.e.*, massive share dumping by investors, any claim arising in connection with Investor's activity would be valid—if broad construction were given. Arguably, broad construction of causation would be no different from previous models, granting an overreaching extension of jurisdiction by the courts. Further, such a broad construction would leave the courts with no better definition for application than previous models resulting in the same inconsistency that has been experienced with balancing tests. Broad construction would seem to promote bias in favor of unfortunate investors making the test inherently unfair to defendants.

However, if a narrow construction were applied, the opposite would result. In the above example, the U.S. investor could not establish either transactional causation nor damages causation. His decision to sell his shares were for personal reasons totally unrelated to Investor's transaction or the subsequent market fluctuations. Similarly, his decision to sell and his resulting losses were in keeping with the inherent risk involved in market participation. Without knowledge of Investor's involvement the dramatic price failure did not, in fact, create his losses. Therefore, under a narrow construction of causation, no claim could be established. Essentially, narrow construction would prevent the court from exercising jurisdiction as an accommodation to an injured party merely for the sake of offering a remedy that would not otherwise lie.

If these principles of causation are applied narrowly, courts would not be faced with ambiguous tests, rather application could be rendered consistently and predictably without bias.

C. SEC Enforcement v. Private Claims

Assuming that narrow construction is appropriate, how might application be different if an action of enforcement were brought by the SEC as opposed to a private claim as described above? Bearing in mind that the interest of the SEC is much broader, *i.e.*, watching over the interests of all U.S. investors and the integrity of the markets, causation must be viewed in a different light. When Investor engaged in activity that is admittedly in violation of SEC regulations, the SEC's interest hinges on the market impact rather than individual impact. Here, where transactional causation might be lacking for a private investor, transactional causation can be established in an enforcement action by the inducement of investors participating in trading on the New York Stock Exchange (NYSE) to sell their

interests at substantial losses. Such an influence jeopardizes the stability of the market which the SEC was established to protect. Additionally, damages causation can be established in the price failure of related and unrelated stocks traded on the NYSE. Thereafter, investors may panic, further perpetuating overall catastrophe. As we have seen, the potential effects arising out of such problems enhance the interests of world-wide market regulators in combatting "global effect conduct."

IX. CONCLUSION

By placing a greater emphasis on causation principles, coupled with the already existing conduct and effects tests, the need for balancing foreign policy is eliminated. This proposed "new" territorialism would eliminate the balancing of foreign policy and replace that test by augmenting the conduct test with principles of causation.

By altering the overall framework of extraterritorial jurisdictional models, several goals could be reached. First, such a test would be predictable. Causation is a principle that has been universally recognized.¹⁶² When courts apply the conduct test, tempered with causation, few problems of inconsistency would result. To the contrary, such a standard is consistent with fundamental legal theory in the form of territorialism in the U.S. and abroad. Judicial authority would rest upon traditional constitutional conventions of accepted jurisdictional limits without usurping Executive and Congressional territory. Further, tension and conflict between states, caused by extraterritorial exertion of jurisdiction, would be greatly reduced since this new territorialism would be more in tune with accepted principles of other nations.

The effect of the territorialist perspective is that foreign corporations and individuals may predict when U.S. courts will exercise jurisdiction over foreign transactions. This model provides a neutral, predictable, and consistent application of jurisdiction over foreign initiated transactions. Therefore, foreign regulators of securities markets in other countries may be more willing to acknowledge the need for extraterritorial regulation of securities markets and thus more actively pursue a cooperative system of regulation. To the extent that

162. See *Imperial Chemical Industries Ltd. v. Commission of the European Communities* (the Dyestuffs case), 11 Common Mkt. L.R. 557 (Ct. of Justice 1972); Court of Justice of the European Communities, Reports of Cases before the Court, 1972, Part II, (Luxembourg) 619, 694.

the force of technology invites movement toward total globalization of securities trading, one might venture to explore the possibility of one world market with many locations around the world, jointly regulated by member countries. Additionally, this causation model conforms to the underlying philosophies of the United States Congress exhibited in the provisions of sections 78aa and 78dd of Title 15. Since the original intent behind section 78dd was to exempt foreign transactions from U.S. jurisdiction unless the transaction causes harm to U.S. investors or markets, greater emphasis on causation principles would give added meaning to the conduct and effects tests in relation to statutory limitations.

A final question remains in assessing how such a model fits into the underpinnings of traditional territorialism. Causation is distinctly in conformity with those principles. Principles of causation reaffirm traditional notions of sovereign power by giving a more coherent basis of application to models previously established. The reality of globalization requires the transformation of territorialism from traditional theories of distinct borders to a new territorialism which incorporates the responsibility of nations to harmonize internal laws and regulations with other nations to protect common interests. Surely the current state of internationalization of the securities market is on the cutting edge of common interests. The various jurisdictional "parts" form a component system that creates the network for the exercise of extraterritorial jurisdiction. The components form a layered system of application, integrating necessary provisions which, taken as a whole, make the system viable while protecting territorial independence.

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